

No. 12803

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United States  
Court of Appeals  
for the Ninth Circuit.

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FRED C. HALL,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

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Transcript of Record

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Petition to Review a Decision of the Tax Court  
of the United States

FILED

MAY 7 1951

PAUL P. O'BRIEN,  
CLERK.



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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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## APPEARANCES

ELI FREED, ESQ.,  
For Petitioner.

T. M. MATHER, ESQ.,  
For Respondent.





The Tax Court of the United States  
Docket No. 21027

FRED C. HALL,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

DOCKET ENTRIES

1948

Nov. 23—Petition received and filed. Taxpayer notified. Fee paid.

Nov. 24—Copy of petition served on General Counsel.

Nov. 23—Request for Circuit hearing in San Francisco filed by taxpayer. 12/10/48 Granted.

Dec. 22—Answer filed by General Counsel.

Dec. 22—Request for hearing in San Francisco filed by General Counsel.

Dec. 23—Copy of answer and request served on taxpayer. San Francisco.

1949

Sept. 9—Hearing set November 7, 1949—San Francisco calendar.

Nov. 7—Hearing had before Judge Harron on Merits. Briefs due 12/22/49. Replies 1/26/50.

1949

Dec. 7—Transcript of hearing 11/7/49—Filed.

Dec. 9—Brief filed by General Counsel. Copy served 12/21/49.

Dec. 21—Brief filed by taxpayer. Copy served 12/21/49.

1950

Jan. 11—Reply brief filed by General Counsel. Copy served.

Jan. 25—Reply brief filed by taxpayer. Copy served.

Aug. 31—Findings of fact and opinion rendered, Judge Harron. Decision will be entered for respondent. Copy served.

Aug. 31—Decision entered. Judge Harron, Div. 13.

Nov. 24—Stipulation of venue filed.

Nov. 24—Petition for review by U. S. Court of Appeals, 9th Circuit, with assignments of error filed by taxpayer.

Nov. 24—Notice of filing petition for review filed by taxpayer.

Nov. 24—Designation of contents of record on review filed by taxpayer.

Nov. 24—Affidavit of service by mail of petition for review, notice of filing petition for review and designation of record filed.

Nov. 27—Proof of service of petition for review filed.

The Tax Court of the United States

Docket No. 21027

FRED C. HALL,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION

The above named petitioner hereby petitions for a redetermination of the deficiencies set forth by the Commissioner of Internal Revenue in his notice of deficiency (Bureau Symbols IRA:90-D:WBH (C:TS:PD SF:ORM) dated October 26, 1948, and as a basis of his proceeding alleges as follows:

1. The petitioner is an individual whose present residence is Oakland, California, and whose address for purposes herein is c/o Freed, Gebauer & Freed, 1069 Mills Building, San Francisco 4, California. The returns for the periods involved herein were filed with the Collector of the 18th District of Ohio.

2. The notice of deficiency (a copy of which is attached and marked Exhibit "A") was mailed to the petitioner October 26, 1948.

3. The taxes in controversy are income and victory taxes for the taxable year ended December 31, 1943, in the sum of \$614.96, and income taxes for the taxable year ended December 31, 1944, in the sum of \$952.67.

4. The determination of taxes set forth in said

notice of deficiency is based upon the following errors:

(a) The Commissioner erred in holding that the sum of \$5,000.00, representing the fair market value of 50 shares of stock of the Ohio Aircraft Fixture Company received by petitioner in 1942, was not income realized by petitioner in 1942 but should be divided and allocated one-half or \$2,500.00 to the year 1943 and one-half or \$2,500.00 to 1944 and taxable in such years accordingly.

(b) The Commissioner erred in holding that a certain agreement in writing (a copy of which is attached hereto and marked Exhibit "B") entitled "Employment Contract," made November 25, 1942, between Ohio Aircraft Fixture Company and Fred C. Hall, the petitioner herein, provides that the 50 shares of stock of the Ohio Aircraft Fixture Company to be received by petitioner as provided in paragraph 5 of such agreement, was not realized by him as income at the time of the issue of said stock and the deposit thereof with the treasurer of the company in 1942, but was income to petitioner when delivered to him by the treasurer of the company as therein provided, viz., 25 shares on December 1, 1943, and 25 shares on December 1, 1944.

5. The facts on which the petitioner relies as the basis of this proceeding are included in and controlled by the agreement aforesaid (Exhibit "B" attached hereto), together with the facts that the two certificates aforesaid for 25 shares each were issued to petitioner and delivered to him and endorsed in blank by him and deposited by him with the

treasurer of the company in 1942 as security for his faithful performance. Thereafter and in accordance with petitioner's faithful performance of said contract, one certificate for 25 shares of stock was released from deposit by the treasurer aforesaid and delivered to petitioner December 1, 1943, and the other certificate for 25 shares of stock was released by the treasurer and delivered to petitioner December 1, 1944.

Wherefore, the petitioner prays that this Court may hear the proceeding and determine that there are no deficiencies in income and victory taxes for the taxable year ended December 31, 1943 and income tax for the taxable year ended December 31, 1944.

/s/ ELI FREED,

Counsel for Petitioner.

State of California,  
County of Alameda—ss.

Fred C. Hall, being duly sworn, says that he is the petitioner above named; that he has read the foregoing petition or had the same read to him, and is familiar with the statements contained therein, and that the statements contained therein are true, except those stated to be upon information and belief, and that those he believes to be true.

/s/ FRED C. HALL.

Subscribed and sworn to before me this 13th day of November, 1948.

[Seal]     /s/ ANDRO J. MACHO,  
Notary Public in and for the County of Alameda,  
State of California.

My commission expires Aug. 3, 1951.

Received and filed T.C.U.S. November 23, 1948.

Served November 24, 1948.

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[Title of Tax Court and Cause.]

### ANSWER

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed by the above-named petitioner admits and denies as follows:

1, 2 and 3. Admits the allegations contained in paragraphs 1, 2 and 3 of the petition.

4 and 4(a) and (b). Denies that the Commissioner erred in the determination of the deficiencies as alleged in paragraph 4 of the petition and subparagraphs (a) and (b) thereunder.

5. Admits that one certificate for 25 shares of stock was delivered to petitioner December 1, 1943, and the other certificate for 25 shares of stock was delivered to petitioner December 1, 1944, but denies



the remaining allegations contained in paragraph 5 of the petition.

6. Denies generally and specifically each and every allegation in the petition not hereinbefore admitted, qualified or denied.

Wherefore, it is prayed that the Commissioner's determination be approved and the petitioner's appeal denied.

/s/ CHARLES OLIPHANT,  
Chief Counsel, Bureau of  
Internal Revenue.

Of Counsel:

B. H. NEBLETT,  
Division Counsel;

T. M. MATHER,  
Special Attorney,  
Bureau of Internal Revenue.

Received and filed T.C.U.S. December 22, 1948.

The Tax Court of the United States  
Docket No. 21027

FRED C. HALL,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Met, pursuant to notice, at 4:30 o'clock p.m.

Before: Hon. Marion J. Harron, Judge.

Appearances:

ELI FREED,

1609 Mills Building,

San Francisco, California,

Appearing on behalf of the Petitioner.

T. M. MATHER,

(Hon. Charles Oliphant, Chief Counsel, Bureau  
of Internal Revenue)

Appearing for the Respondent.

PROCEEDINGS

The Clerk: I will call next Docket No. 21027,  
Fred C. Hall.

Please state your appearances, gentlemen, for  
the record.

Mr. Freed: Eli Freed, appearing for the Petitioner.

Mr. Mather: T. M. Mather, for Respondent.



The Court: Mr. Freed, would you please proceed.

Opening Statement on Behalf of Petitioner

By Mr. Freed:

Mr. Freed: I would like to make a short opening statement.

The issue, as I see it, in this matter is a very simple one. It concerns whether or not 50 shares of the capital stock of an Ohio corporation, Ohio Aircraft Fixture Company, issued in 1942 to Fred C. Hall, the taxpayer, and pursuant to a written employment contract which was made by him in the Ohio Aircraft Fixture Company in November, 1942, was income in 1942, taxable income in 1942, or income in the following two years on the basis of 25 shares of such stock which were released to him in December of 1943 and 25 shares of stock released to him by the Company in December of 1944.

The contract, written contract, which is the basis for the disposition, as I see it, of this issue, has in it Paragraph 5, which provides: The first party; that is, the [3\*] Ohio Aircraft Fixture Company, shall issue 50 shares of stock of the company in consideration of the signing of this employment contract and to carry out certain contracts necessary in the prosecution of the war. Two certificates are to be issued, each to be for 25 shares, and endorsed in blank. They are to be deposited with the Treasurer of the company for the faithful performance of this contract, one certificate for 25 shares to be delivered on December 1st, 1943, and the other certificate for

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\* Page numbering appearing at top of page of original Reporter's Transcript of Record.

25 shares to be delivered on December 1st, 1944, on the order of the Board of Directors.

Our position is that those shares were issued to Fred C. Hall at or about the time he signed the employment contract in 1942, that he became the owner of them, entitled to all the rights of an owner, and that he had the obligation of depositing those shares of stock with the Treasurer of the company as a guarantee or surety for the performance, and the income was taxable, based upon the fair market value of those shares that was realized in 1942.

The Court: Is there any question about the amount of the income that was realized?

Mr. Mather: I don't know of any question.

The Court: That is, the amount of the income would be the fair market value of the stock?

Mr. Freed: There seems to be no controversy regarding the fair market value. [4]

Mr. Mather: None whatever.

The Court: All right. Mr. Mather?

Opening Statement on Behalf of Respondent

By Mr. Mather:

Mr. Mather: It is the position of the Respondent, if your Honor please, that this was income to the Petitioner on the receipts and disbursements basis in the year that the certificates were received in '43 and '44.

The Court: On the theory that that would be the earliest time in which he would have dominion and control over the certificates and the proceeds that could be realized from them?

Mr. Mather: Although the contract provides that

he is to receive the certificates, he is not to receive them under the contract until '43 and '44, and at that time it was income to him.

The Court: Have you stipulated to that?

Mr. Freed: No, we have not, but I just talked to Mr. Mather and it appears there seems to be no material dispute on the facts. Is that correct?

Mr. Mather: None that I know of.

The Court: Are any of the facts set forth in the Petition admitted?

Mr. Mather: Some of them are admitted. The contract isn't admitted but I will stipulate that Exhibit B, referred [5] to in Paragraph 5, attached to the Petition, is a copy of the contract.

Mr. Freed: Yes.

Mr. Mather: And then it is admitted that one certificate for 25 shares of stock was delivered to the Petitioner on December 1, 1943, and the other certificate for 25 shares of stock was delivered to the Petitioner on December 1, 1944.

Mr. Freed: Will it be stipulated that the two certificates of stock were given to Mr. Hall, the taxpayer, at or about the time he signed the contract, issued in his name, and that thereafter he endorsed the certificates and deposited them with the Treasurer of the Ohio Aircraft Fixture Company; that is, in 1942?

Mr. Mather: It will be stipulated that the contract of Exhibit B, referred to and attached to the stipulation, was carried out, and that provides for the issuance of the stock to Mr. Hall and his en-

dorsement in blank and being returned, and that that was done.

Mr. Freed: In '42?

Mr. Mather: In '42.

Mr. Freed: I think we probably have the case right there.

The Court: Are you going to offer any exhibits, Mr. Freed? [6]

Mr. Freed: Just the contract, I believe.

The Court: The contract is received in evidence as Petitioner's Exhibit 1.

(Whereupon the document was marked for identification as Petitioner's Exhibit 1 and was received in evidence.)

## PETITIONER'S EXHIBIT No. 1

### Employment Contract

This Agreement made at Cleveland, Ohio, this 25th day of November, 1942, by and between Ohio Aircraft Fixture Company, an Ohio corporation, of Cleveland, Ohio, hereinafter called "First Party" and Fred C. Hall of Cleveland, Ohio, hereinafter called "Second Party,"

Witnesseth:

The Parties hereto mutually agree as follows:

1. That the First Party [the Company] hereby hires the Second Party [petitioner] and the Second Party agrees to work for First Party in the capacity of Manager of the Service Engineering Department, in charge and responsible for all sales

and advertising, formulating and figuring all selling prices in co-operation with the shop engineering and cost departments and to assist the factory manager in scheduling and planning production in First Party's business of general manufacturing, particularly aircraft, jigs and fixtures for a period of two (2) years, commencing on the 15th day of November, 1942, and ending on the 14th day of November, 1944.

2. Said Second Party shall at all times during such term of employment give his full attendance and to his best endeavors and to the utmost of his skill and abilities exert himself for the profit, benefit and advantage of said business and perform such duties in said capacities as shall be required of him from time to time by First Party.

3. First Party shall pay the Second Party for his services hereunder as salary and compensation at the rate of One Hundred and Twenty-five (\$125.00) per week in addition to ten per cent (10%) of the profits over \$5,000.00 before Federal Taxes and after providing for all known reserves for contingencies; of the salary \$100.00 is to be paid in cash each week, \$25.00 and the said ten per cent, at the option of the Directors of the Company, may be paid in cash or in stock of the Company and shall be payable on or before January 15th of each year and shall cover the preceding year.

4. It is agreed by and between the parties that in case of illness, the base salary shall continue at full rate for six (6) months, half rate for a consecutive six (6) months and quarter rate for the



balance of the term of the contract in excess of two six months periods, the additional salary, if any remaining the same. First Party through its Boards of Directors, if it deems advisable, may demand Certificate of Inability to perform on account of illness from one or more reputable physicians.

5. First Party shall issue fifty (50) shares of stock of the Company in consideration of the signing of this employment contract and to carry out certain contracts necessary in the prosecution of the war. Two certificates are to be issued. Each to be for twenty-five shares and endorsed in blank. They are to be deposited with the Treasurer of the Company for the faithful performance of this contract. One certificate for twenty-five shares to be delivered on December 1, 1943 and the other certificate for twenty-five shares to be delivered on December 1, 1944, on the order of the Board of Directors.

6. Second Party agrees that during the life of this contract he will not engage in any manner either directly or indirectly engage in any other gainful occupation without consent of the Board of Directors; and shall further be directly responsible to the Board of Directors of the Company for the operation of his departments and said Directors shall from time to time determine the operating policies of these departments.

7. It is agreed by and between the parties that this contract will be considered performed on death of the Second Party.

In Witness Whereof, The First Party has caused its corporate seal to be hereunto affixed and its cor-

porate signature attached by H. H. Warnsman, Secretary, and B. P. Fortney, President, and Second Party has hereunto set his hand as of the date and year first above written.

OHIO AIRCRAFT FIXTURE  
COMPANY,

[Seal] By /s/ H. H. WARNSMAN,  
Secretary,

By /s/ B. P. FORTNEY,  
President,  
First Party.

/s/ FRED C. HALL,  
Second Party.

Signed in the presence of:

/s/ F. E. POTTING,

/s/ T. J. COOK.

Admitted November 7, 1949.

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Mr. Freed: If you want some background, I have Mr. Hall here.

The Court: Well, since there is no objection to the authenticity of the contract, you may offer it at this time and it can be received in evidence.

The Clerk: Exhibit 1.

The Court: Now if you want to call Mr. Hall, you may call him at this time.

Whereupon,

FRED C. HALL

was called as a witness on behalf of the Petitioner and having been first duly sworn, testified as follows:

The Clerk: State your name and address.

The Witness: Fred C. Hall, 10975 Elvessa Avenue, Oakland.

Direct Examination

By Mr. Freed:

Q. Now, Mr. Hall, you were a resident of Cleveland, Ohio, in 1942, to and including 1945, were you not? [7]      A. Yes.

Q. You worked with the American Coach and Body Company, an Ohio corporation, in Cleveland, Ohio, immediately preceding November, 1942, did you not?      A. Yes.

Q. And what was your position with the company?

A. I managed the Jig & Fixture Division for the American Coach and Body Company.

Q. Now, prior to and during the month of November, 1942, you associated yourself with some men in Cleveland, Ohio, for the purpose of forming the Ohio Aircraft Fixture Company, did you not?

A. Yes.

Q. What was the purpose of the organization of that company? What did it undertake to do?

A. To purchase the Jig & Fixture Division of the American Coach and Body Company.



(Testimony of Fred C. Hall.)

Q. Did you give up your employment with the American Coach and Body Company to become an officer, director and employee of the Ohio Aircraft Fixture Company in November, 1942?

A. Yes.

Q. I show you Petitioner's Exhibit 1, which is in evidence, entitled "Employment Contract," and that is the contract which you entered into with the Ohio Aircraft Fixture Company, is it not? [8]

A. Yes.

Q. Now, this employment contract in Paragraph 5 thereof refers to 50 shares of the stock, of the capital stock, of the Ohio Aircraft Fixture Company to be issued to you in the form of two certificates of 25 shares each in consideration of the signing of that contract, and it goes on and says, "and to carry out certain contracts necessary for the prosecution of the war." When did you first see those certificates for 25 shares each?

A. When they were handed to me by Mr. Warnsman.

Q. And Mr. Warnsman was an officer of the Ohio Aircraft Fixture Company? A. Yes.

Q. And that was in the latter part of 1942?

A. Yes, it was.

Q. And did you examine those certificates at that time? A. I did.

Q. And did they disclose the fact that they were issued in your name, each of them? A. Yes.

Q. That is, both of them and each was for 25 shares of stock? A. Yes.

(Testimony of Fred C. Hall.)

Q. Then what did you do with those certificates?

A. I examined them and endorsed them and gave them to [9] Mr. Fortney.

Q. And he was an officer of that corporation?

A. He was.

Q. That is, the Ohio Aircraft Fixture Company. And you began working for that Company November 15, 1942? A. Yes, I did.

Q. And when were those certificates returned to you?

A. One certificate was returned late in 1943 and another in 1944, late in the year.

Q. And when the second certificate was returned to you, were you working for that company?

A. Yes, I was.

Q. Did you continue to work for that company thereafter? A. I did.

Q. And you worked for them until some time in September, was it, of 1945? A. Yes.

Q. And then you sold your shares of stock at that time? A. Yes, I did.

Q. How much did you sell those shares of stock for? A. \$150 each share.

Mr. Freed: No further questions.

Mr. Mather: No cross-examination.

Mr. Freed: That is all.

The Court: I might want to ask the witness a question or [10] two.

How many stockholders were there of the Ohio Aircraft Fixture Company?

The Witness: There were five stockholders.

(Testimony of Fred C. Hall.)

The Court: How much stock was issued?

The Witness: Equal amounts were issued to three stockholders, Mr. Warnsman, Mr. Fortney, and myself.

The Court: In a total amount of how many shares?

The Witness: Originally, the three of us—let's see. There were four, Mr. Wilson also. 231 shares originally.

The Court: Do I understand you to mean that out of a total of 231 shares you were to receive 50 shares and the other three gentlemen were to receive 50 shares?

The Witness: 50 shares each, yes.

The Court: That would be 200 shares.

The Witness: 200 shares.

The Court: What were the other 31 shares for?

The Witness: The other three gentlemen each purchased ten shares at the time of organization and I purchased one share.

The Court: Was an employment contract executed by the other three stockholders?

The Witness: Yes.

The Court: And then all of you turned back your stock to the Secretary of the Company, or to someone, to the [11] Treasurer of the Company?

The Witness: Yes. That clause was uniform in all of the contracts.

The Court: Why was that done?

The Witness: That was to be a bond that we would faithfully perform the contracts.

(Testimony of Fred C. Hall.)

The Court: What contracts?

The Witness: The contracts to serve the company for a two year period, as stipulated in each contract.

The Court: It is an unusual kind of contract arrangement, because ordinarily when a new company is organized and stock is issued, it is issued for capital, and if 200 shares out of 231 shares were issued as compensation for services, it would mean that only 31 shares were issued for capital. It is hard to understand. I wonder if there is any explanation for that.

The Witness: May I explain. This new management was taking over a going concern and the only immediate problems were to supply enough operating capital to take care of the current demands. There were valuable contracts involved that we knew should be profitable and they later proved to be profitable, and tools and machinery were purchased from the American Coach and Body Company on very lenient terms and even the personnel was transferred over from the American Coach and Body Company to carry the business on. [12]

The Court: That is, you had war contracts or contracts with the Government that were to be performed?

The Witness: Yes.

The Court: And were those supposed to be the source of the capital requirements, the payments under those production contracts?

The Witness: Well, we intended to accumulate some capital as we went along, from that source.

(Testimony of Fred C. Hall.)

The Court: Why was this stock issued to you in addition to binding your agreement to give your services to the organization? Why was the stock issued to you?

The Witness: As an incentive to me to leave the place I had been employed for a six-year period and take the responsibility of completing the contracts that were taken over with the business.

The Court: Was that supposed to be a monetary inducement?

The Witness: I would say so, yes.

The Court: Well, in this agreement, no value is ascribed to the shares of stock. Did the stock have a par value?

The Witness: The value was established. It was a no par stock. The value was established by the directors.

The Court: When?

The Witness: At the first stockholders'—at [13] the first shareholders' meeting.

The Court: Was that in 1942, about the time this agreement was executed, the agreement of November 25, 1942?

The Witness: About that time, yes. I would say right in there.

The Court: What was the value that was ascribed to the capital stock?

The Witness: \$100 per share.

The Court: Then am I to understand that when this 50 shares of stock was issued to you, you had an understanding that that had a value of \$5,000?

The Witness: Yes, that is right.



(Testimony of Fred C. Hall.)

The Court: Now, you say that you ultimately disposed of this stock and you stated what you disposed of it for. What did you dispose of it for?

The Witness: \$150 per share.

The Court: \$150 per share?

The Witness: Yes.

The Court: \$50 more per share than the value that was ascribed to it?

The Witness: Yes.

The Court: I don't know whether all these questions are strictly material, counsel, but I have started a line of questions and it leads me to a few others, so if you have any objection to any of these questions, please feel free to object. [14] Have you any objection?

Mr. Freed: None yet.

The Court: I started to ask you who bought the stock from you? I don't know whether it is material or not.

The Witness: Mr. Warnsman and Mr. Fortney.

The Court: Is this company still in existence?

The Witness: No, it is not.

The Court: The question in this case, Mr. Hall, appears to turn upon the construction of the clause in the contract, and while you are here and in the court room, I will ask you to look at Paragraph 5 of that employment agreement. That is an agreement that you signed and I expect you understood the agreement when you signed it, so perhaps you can tell the Court what your understanding of that agreement was.

(Testimony of Fred C. Hall.)

The Witness: Yes.

The Court: May I have the Exhibit 1, Mr. Baird.

We don't have the shares of stock here but I assume the two certificates for 50 shares were issued in your name?

The Witness: Yes.

The Court: Now, the contract says that the certificates were to be issued "each to be for 25 shares and endorsed in blank." It doesn't say endorsed in blank by whom and it doesn't say to be issued to whom. What does that mean?

The Witness: They were issued to me and they were [15] endorsed by me.

The Court: How long was this employment contract supposed to extend?

The Witness: Two years, two years from November 15, 1942.

The Court: Do you have any idea about what the purpose of this clause was, that is set forth in Paragraph 5?

The Witness: I will give you my understanding of it.

The Court: Very well.

The Witness: Prior to signing the contract it was agreed that I was to receive 50 shares of stock for signing the contract and then I was to endorse the stock certificates back to the officer of the company that was prescribed, and the purpose of my signing the contract was to enable the company to carry out certain important contracts we were

(Testimony of Fred C. Hall.)

taking over to furnish aircraft tools, jigs, and fixtures to the Curtiss Wright Corporation in St. Louis and to the newly-organized Aircraft Division of the Firestone Tire & Rubber Company. That is where they refer to "and to carry out certain contracts necessary in the prosecution of the war." That was my understanding and is my understanding of the entire matter.

The Court: What is your understanding of the provision that required you to endorse the certificates and [16] return them to the Treasurer of the Company?

The Witness: Well, I would believe that if I failed to perform under the contract, owing to the responsibility that the company had to complete those contracts I would need to be replaced, and if there were expense or damages involved in replacing me or because I didn't complete the contract, those damages could be recovered from the value of the stock that they were holding that had been issued to me.

The Court: That is all.

Mr. Freed: No questions.

### Cross-Examination

By Mr. Mather :

Q. Mr. Hall, you didn't pay anything for this stock other than this employment agreement?

A. I paid no money for it at that time.

Q. And it was because of your services in con-



(Testimony of Fred C. Hall.)

nection with the company that you received the compensation provided in this employment agreement and also the stock?

A. The compensation is outlined, I believe, in the contract, and those were for my services. It refers specifically to rate of pay in the contract.

Q. Well, there were similar contracts with the Secretary and President, Warnsman and Fortney, were there not?           A. Yes.

Q. For similar amounts of stock? [17]

A. Yes.

Q. And they were to perform services also for the Company?           A. Yes.

Mr. Mather: That is all.

The Court: I believe the witness has testified, Mr. Mather, that the stock was issued to him as the consideration for his signing the contract. Now, there may be some question about whether the stock itself was compensation for services. That would be a question of fact, I believe, and not a question of interpretation of the contract. I realize that the case is really submitted for decision upon the basis of this contract and that the Court will be asked to construe the contract.

Well, it is a simple contract and although the contract ought to speak for itself, if it doesn't, anything else ought to be covered, ought to be established by evidence. It would be a matter of fact, and it would be a matter of proof and that is why the Court asked the witness a few more questions. If

(Testimony of Fred C. Hall.)

there is anything else that you can establish by the testimony of this witness, please do so.

Mr. Freed: I would like to make a comment that might lead somewhere. Some of your Honor's questions were directed to the idea of what capital stock was supplied to this company. [18]

The Court: Those were exploratory questions.

Mr. Freed: Yes. I, of course, had the same curiosity when it first came to me, and Mr. Hall's testimony in response to those questions, as I understand it, is that the company had certain valuable contracts and that they were taking over a going business, and seeing that there was no issue as to fair market value involved, it would seem to me that that could be looked to only for the purpose of interpretation or construction of the contract. It has nothing to do whatsoever with the contribution of capital by the stockholders for the shares of stock.

The Court: You understand that with the limited acquaintance I have with the situation, I just wanted to eliminate certain things by asking those questions. Some of them are not material but it gives a little better understanding of what the situation was.

Now, this contract states in Paragraph 3 that the party of the second part, who is Mr. Hall, the Petitioner in this case, is to receive a salary, and the salary is fixed at \$125 a week in addition to ten per cent of the profits over \$5,000. That is supposed to state what the compensation of the company was

(Testimony of Fred C. Hall.)

to this taxpayer for his services to the company.  
Is there anything further?

Mr. Mather: I might just ask one question.

Q. The Board of Directors did make and order for the [19] delivery of the stock to you, as provided in Paragraph 5, did it not, at or about the time the stock was delivered?

A. It was delivered to me in accordance with the contract, the terms of the contract.

Q. Yes, which provided that one certificate for 25 shares was to be delivered on December 1, 1943, and the other certificate for 25 shares to be delivered on December 1, 1944, on order of the Board of Directors? A. It was returned, yes.

Q. Pursuant to that? A. Yes.

Mr. Mather: That is all.

The Court: Well, now I believe I have one more question.

Did you report this item for income tax purposes in some return?

The Witness: Yes, in 1942.

The Court: What did you report in your income for 1942?

The Witness: The salary I had drawn prior to this plus the \$5,000 stock value.

Mr. Freed: Do you have the return, Mr. Mather, for '42?

The Court: Is that true, that the taxpayer did report this for income in '42? [20]

Mr. Freed: We can put the return in evidence, your Honor.

(Testimony of Fred C. Hall.)

The Court: As I understand it, the Commissioner added \$5,000 to income for '43 and \$5,000 to——

Mr. Freed: \$2,500.

The Court: What did you say?

Mr. Freed: The Commissioner eliminated the \$5,000 income attributable to stock for 1942 and added \$2,500 attributable to that stock to his income in 1943 and \$2,500 is added to his income in 1944.

The Court: Well, in the statement attached to the notice of deficiency on Page 4 it is said that the fair market value of 25 shares of stock of the Ohio Aircraft Company "received as compensation" represents income in the taxable year 1943, and the same explanation is given on Page 6, the other adjustment for income for 1943—just strike that. I have to find out what the trouble is. I have located what was giving me some concern.

Q. (By Mr. Mather): Now, Mr. Hall, do you know what your salary was from the Ohio Aircraft Fixture Company in 1942?

A. That was the year we started. I can't name the figure, no.

Q. Well, would \$9,691.50 refresh your recollection to any extent?

A. Well, I believe that is about the [21] figure that was reported, yes, sir.

Q. And it was about the same in '43 and '44, was it? A. I believe it would be, yes.

Q. Now, can you tell me where the \$5,000 for stock is in that return for '42?

(Testimony of Fred C. Hall.)

A. It was reported as income.

Q. Well, is it in that \$9,000?

A. Yes. It is in there.

Q. That is all you got, is \$5,000 worth of stock, which is included in the \$9,000? A. Yes, sir.

Q. Now, in 1943 what was your salary, do you recall? About the same as it was in '42?

A. It was in accordance with the employment contract.

Q. There was no difference in the rate of compensation in '42 and '43 under the employment contract, was there?

A. Well, we only worked under the employment contract about six weeks in '42.

Q. According to the return, it was \$10,015 in '43.

A. That would sound about right.

Q. And \$9,793.54 in '44?

A. Yes. I think these figures that are shown here should be about it, yes, sir.

Mr. Mather: That is all.

Mr. Freed: No questions. [22]

The Court: Thank you very much, Mr. Hall, for giving us your testimony.

(Witness excused.)

The Court: Do both parties rest at this time?

Mr. Mather: Yes.

Mr. Freed: Yes.

The Court: The briefs in this case will be due



(Testimony of Fred C. Hall.)

December 22, 1949, and the reply briefs will be due January 26, 1950.

This proceeding now stands submitted.

(Whereupon, at 5:05 o'clock p.m., the hearing in the above-entitled matter was concluded.) [23]

### Certificate

I, Franklin R. Greene, one of the official reporters of the Tax Court of the United States under its reporting contract, assigned to report certain proceedings during the session of The Tax Court in San Francisco, California, beginning November 7, 1949, do hereby Certify as follows:

That I reported all of the proceedings in the case of Fred C. Hall, Docket No. 21027 on November 7, 1949, before the Honorable Marion J. Harron, Judge of The Tax Court;

That I did well and truly, to the best of my ability, record in Stenotypy fully, completely and accurately all of the proceedings which I was assigned to report, including all colloquy and statements made during the proceedings, and all questions to and answers given by witnesses;

That my stenotype record is full, complete and accurate; and

That the foregoing record is a true, complete and accurate transcript of my stenotype notes of all the proceedings which I reported, and all of the testi-

mony which was taken in the above-entitled cause.

/s/ FRANKLIN R. GREENE.

Date: Nov. 23, 1949.

Filed T.C.U.S. December 7, 1949. [24]

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The Tax Court of the United States

Docket No. 21027

15 T. C. No. 30

FRED C. HALL,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Promulgated August 31, 1950.

## FINDINGS OF FACT AND OPINION

Petitioner, who reported his income on the cash receipts and disbursements basis, was one of the organizers of a corporation in November, 1942. In November, 1942, he entered into an employment contract with the corporation under which he agreed to render services to it during the years 1943 and 1944. As part of his compensation, the corporation issued two certificates of stock in his name, each for 25 shares. He endorsed the certificates in blank and gave them to the treasurer of the corporation. Upon the satisfactory perform-

ance of the required services and pursuant to an order of the board of directors, the treasurer was to deliver one of the share certificates to petitioner at the end of each of the years 1943 and 1944. Held, the fair market value of 25 shares is includible in petitioner's income for each of the years 1943 and 1944, in which years they were delivered to him without restriction in consideration of services performed.

ELI FREED, ESQ.,

For the Petitioner.

T. M. MATHER, ESQ.,

For the Respondent.

The Commissioner determined deficiencies in the petitioner's income and victory tax liability for the year 1943 in the amount of \$614.96, and a deficiency in petitioner's income tax liability for the year 1944 in the amount of \$952.67. The year 1942 is also involved because of the provisions of the Current Tax Payment Act.

The issue in this proceeding is whether the fair market value of 50 shares of stock issued in petitioner's name in 1942 is includible in his gross income for that year, or whether the fair market value of 25 shares is includible in his gross income for each of the years 1943 and 1944 in which they were delivered to him without restriction.

The petitioner filed his returns for the years in question with the collector for the eighteenth district of Ohio. He is now a resident of Oakland, California.



The record in this proceeding consists of the testimony of the petitioner and a copy of the employment contract between the petitioner and the Ohio Aircraft Fixture Company which was introduced into evidence at the trial.

### Findings of Fact

Petitioner was a resident of Cleveland, Ohio, from 1936 to 1945. During the years in question, he reported his income on the cash receipts and disbursement basis. From 1936 to November, 1942, he was employed by the American Coach and Body Company in Cleveland. Prior to leaving the company in November, 1942, he was the manager of its jig and fixture division.

In November, 1942, the Ohio Aircraft Fixture Company (hereinafter referred to as "Company") was incorporated under the laws of Ohio for the purpose of acquiring and operating the jig and fixture division of the American Coach and Body Company. The Company was organized by petitioner and three associates, Warnsman, Fortney, and Wilson. Petitioner purchased one share of stock from the Company at this time, and each of the other three organizers purchased ten shares of stock. The price paid for the stock was \$100 per share. The \$3,100 thus raised was adequate working capital for the needs of the Company which was organized to take over and operate a business which had valuable war production contracts and other assets sufficient for its operations.

The purchase of the jig and fixture division was

consummated in November, 1942, and the Company thereby acquired, on very lenient terms, a going concern, including its personnel, equipment, and valuable war production contracts.

On November 25, 1942, petitioner entered into an employment contract with the Company. This contract provided:

### Employment Contract

\* \* \*

The Parties hereto mutually agree as follows:

1. That the First Party [the Company] hereby hires the Second Party [petitioner] and the Second Party agrees to work for First Party in the capacity of Manager of the Service Engineering Department, in charge and responsible for all sales and advertising, formulating and figuring all selling prices in co-operation with the shop engineering and cost departments and to assist the factory manager in scheduling and planning production in First Party's business of general manufacturing, particularly aircraft, jigs and fixtures for a period of two (2) years, commencing on the 15th day of November, 1942, and ending on the 14th day of November, 1944.

2. Said Second Party shall at all times during such term of employment give his full attendance and to his best endeavors and to the utmost of his skill and abilities exert himself for the profit, benefit and advantage of said business and perform such

duties in said capacities as shall be required of him from time to time by First Party.

3. First Party shall pay the Second Party for his services hereunder as salary and compensation at the rate of One Hundred and Twenty-five (\$125.00) per week in addition to ten per cent (10%) of the profits over \$5,000.00 before Federal Taxes and after providing for all known reserves for contingencies; of the salary \$100.00 is to be paid in cash each week, \$25.00 and the said ten per cent, at the option of the Directors of the Company, may be paid in cash or in stock of the Company and shall be payable on or before January 15th of each year and shall cover the preceding year.

4. It is agreed by and between the parties that in case of illness, the base salary shall continue at full rate for six (6) months, half rate for a consecutive six (6) months and quarter rate for the balance of the term of the contract in excess of two six months periods, the additional salary, if any remaining the same. First Party through its Boards of Directors, if it deems advisable, may demand Certificate of Inability to perform on account of illness from one or more reputable physicians.

5. First Party shall issue fifty (50) shares of stock of the Company in consideration of the signing of this employment contract and to carry out certain contracts necessary in the prosecution of the war. Two certificates are to be issued. Each to be for twenty-five shares and endorsed in blank. They are to be deposited with the Treasurer of the

Company for the faithful performance of his contract. One certificate for twenty-five shares to be delivered on December 1, 1943, and the other certificate for twenty-five shares to be delivered on December 1, 1944, on the order of the Board of Directors.

6. Second Party agrees that during the life of this contract he will not engage in any manner either directly or indirectly engage [sic] in any other gainful occupation without consent of the Board of Directors; and shall further be directly responsible to the Board of Directors of the Company for the operation of his departments and said Directors shall from time to time determine the operating policies of these departments.

7. It is agreed by and between the parties that this contract will be considered performed on death of the Second Party.

Each of the other three organizers entered into similar employment contracts with the Company.

Pursuant to the employment contract, two stock certificates, each representing 25 shares of no-par value stock, were issued in petitioner's name in the latter part of 1942. He endorsed each stock certificate in blank and deposited it with the treasurer of the Company. Certificates representing fifty shares of stock similarly were issued in the names of each of the other three organizers who endorsed the certificates and deposited them with the treasurer of the Company.

Prior to the issuance of the stock, the board of

directors of the Company placed a value of \$100 per share upon each of the shares of no-par value stock, which represented the fair market value of each share. The total number of shares of stock originally issued by the Company was 231. Of this number, 200 shares were issued to the organizers upon their execution of the employment contracts, and 31 were issued to the organizers upon the payment of \$100 per share.

Petitioner began work for the Company on November 15, 1942. During 1943, petitioner received \$6,500 as his base salary from the Company for his services as manager of its service engineering department, and additional compensation of \$3,515 as his share of the profits above \$5,000. In December, 1943, one of the stock certificates representing 25 shares of stock which had been issued in petitioner's name was delivered to him by the treasurer of the Company on the order of the board of directors.

During 1944, petitioner received \$6,500 as his base salary from the Company and additional compensation of \$3,290 as his share of the profits above \$5,000. In December, 1944, the second stock certificate representing 25 shares of stock which had been issued in petitioner's name was delivered to him by the treasurer of the Company on the order of the board of directors.

In September, 1945, petitioner severed his connection with the Company and sold his shares of stock for \$150 per share.



Petitioner became the unrestricted owner of 25 shares of stock in the Company in 1943 in exchange for services which he rendered to the Company in that year.

Petitioner became the unrestricted owner of 25 shares of stock in the Company in 1944 in exchange for services which he rendered to the Company in that year.

In the notice of deficiency, respondent gave the following explanation of the adjustments here in dispute:

Included in your salary for the year 1942 is the fair market value of \$5,000.00 for 50 shares of Ohio Aircraft Fixture Company Stock.

Pursuant to an agreement made November 25, 1942, by and between Ohio Aircraft Fixture Company and you, fifty shares of the capital stock of that company were to be delivered to you in consideration of the signing of the employment contract and to carry out certain contracts necessary in the prosecution of the war. Two certificates were to be issued, each for twenty-five shares, endorsed in blank, and deposited with the treasurer of the company for faithful performance of the contract. One of the said certificates was delivered to you on December 1, 1943, and the second was delivered on December 1, 1944. It is held that the fair market value of each certificate constituted income to you in the year in which it was delivered on the order of the Board of Directors of the said Ohio Aircraft Fixture Company.

## Opinion

Harron, Judge:

The issue in this proceeding is whether petitioner is taxable in 1942 on the value of shares of stock issued in his name in that year, or in 1943 and 1944 when the shares were delivered to him upon his performance of personal services pursuant to an executory contract with the Company.

Petitioner contends that he became the owner of the 50 shares in question in 1942 when the contract was signed by the parties and the shares were issued in his name; that the consideration for their issuance was the signing by him of the employment contract of November 25, 1942; and that the fair market value of the shares was income to him at that time.

Respondent contends that petitioner is taxable in 1943 and 1944 on the fair market value of the shares of stock received by him in those years and not in 1942 when the contract was entered into. He argues that the shares were only provisionally delivered to petitioner in 1942 and that petitioner did not become the unrestricted owner of any of the shares until 1943 and 1944, in each of which years 25 shares were delivered to him without restriction.

Petitioner reported his income during the years in question on the cash receipts and disbursement basis. Section 42 of the Internal Revenue Code provides that "the amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer." A taxpayer on the cash basis normally reports in-



come in the year in which the cash or property in lieu thereof is received, even though services for which the cash or property represent payment are rendered in either an earlier or a later year. *Jackson v. Smietanka*, 272 Fed. 970; *S. P. Freeling*, 7 B.T.A. 1238; *Edwin B. DeGolia*, 40 B.T.A. 845; cf. *Brown v. Helvering*, 291 U. S. 193; *Astor Holding Corp. v. Commissioner*, 135 Fed. (2d) 47; *Your Health Club, Inc.*, 4 T.C. 385.

Although actual receipts remain the touchstone of the cash basis of reporting income, both decisions and regulations include constructive as well as actual receipts as income. E.g., *Corliss v. Bowers*, 281 U. S. 376; *Ross v. Commissioner*, 169 Fed. (2d) 483; *Warren E. Burns*, 11 B.T.A. 524; *aff'd.*, 31 Fed. (2d) 399; *certiorari denied*, 280 U. S. 564. Regulation 111, section 29.42-3, which enunciates the doctrine of constructive receipt includes as taxable income all amounts owing to the taxpayer on the cash basis, whether actually received or not, which are unqualifiedly made subject to his demand in the taxable year.

Conversely, where cash or a chose in action, such as a stock certificate or a note, is not received free and clear but is subject to a restriction, the usual effect of the restraint is to postpone the inclusion of the item in taxable income until such time as the restriction is removed. E.g., *International Mortgage & Investment Corp.*, 36 B.T.A. 187; *Benjamin F. Patterson*, 21 B.T.A. 8; *Marion H. McArdle*, 11 T.C. 961; *Charles F. Mitchell*, 45 B.T.A. 300; *E. P. Madigan*, 43 B.T.A. 549.

There is no evidence in this proceeding on such matters as who dictated the policies of the Company, what its capital structure was, what assets and liabilities comprised its balance sheet, whether any of the shares held by the treasurer were ever voted, whether dividends were ever declared by the Company, and, if so, whether dividends were ever paid by the Company upon the shares which were being held by the treasurer.

Upon our examination of the limited facts which have been made available to us, we must conclude that petitioner did not receive the 50 shares in question in 1942 free and clear from restrictions which would make them subject to his unfettered command. Instead, it is held that respondent was correct in his determination that it was not until 1943 and 1944 that the shares were subjected to petitioner's control, and that the fair market value of the shares delivered in each of those years was includible in petitioner's income for the year in which they were delivered.

The petitioner had no dominion or control over the shares until they were delivered to him by the treasurer of the Company in 1943 and 1944 upon the order of the board of directors. There is no evidence that the petitioner was entitled to vote the shares prior to that time or that he was entitled to share in any dividends which might be declared by the Company. The petitioner could not sell the shares which were being held by the treasurer until they were delivered to him, and the unfettered

right of sale is one of the most important attributes of ownership.

The facts which are before us in this proceeding are similar to those in other cases in which formal restrictive devices have resulted in tax postponement until the year in which the property was unrestrictedly delivered into the possession of the taxpayer. Thus, in Phillip W. Haberman, 31 B.T.A. 75; *aff'd.*, 79 Fed. (2d) 995, the taxpayer agreed with a corporation to remain in the employ of one of its subsidiaries for three years for a compensation consisting of a stated cash salary and the right to purchase a stated number of shares of the parent's stock. Stock certificates for fully issued and paid-up shares were issued to the taxpayer, immediately endorsed by him, and deposited with the parent to secure a loan for the full purchase price of the shares. Upon repayment of the loan in installments, in subsequent years, the taxpayer was entitled to receive the shares of stock. Upon those facts, it was held that the taxpayer, who was on the cash basis, received income in the years in which the stock was finally received by him rather than in the year in which the stock was issued.

In Lyle H. Olson, 24 B.T.A. 702; *aff'd.* 67 Fed. (2d) 726; *certiorari* denied, 292 U. S. 637, a corporate employer agreed to issue 200 shares of its stock to Olson in consideration of his continuous performance of services for the next five years. Each year from 1918 through 1922 a certificate for 40 shares was issued in Olson's name and delivered to a trustee designated by him. In 1922 at the end

of the five years, the shares of stock were delivered to Olson. It was held that, since Olson reported his income on the cash basis, the entire 200 shares were includible in his income in 1922 in the amount of their fair market value. Cf. Adolph Zukor, 33 B.T.A. 324.

In Marion H. McArdle, *supra*, the taxpayer sold stock and as part of his consideration received a cashier's check which he endorsed and deposited with the buyer in order to guarantee the buyer against loss from accounts receivable and contingent liabilities of the corporation whose stock was being purchased. It was held that the profit represented by the portion of the sales price so deposited was not income to the cash basis seller in the year of sale, but only in the following year when received unconditionally. See, also, Preston R. Bassett, 33 B.T.A. 182; *aff'd.*, 90 Fed. (2d) 1004.

And in Roscoe H. Aldrich, 3 B.T.A. 911, where a corporation agreed to compensate a taxpayer for entering into a contract with another corporation and becoming its general manager for a period of five years by depositing in escrow 500 shares of stock to be delivered to the taxpayer at the expiration of five years, the dividends payable on the stock during the escrow period to be paid to the taxpayer, it was held that the taxpayer did not become the owner of the stock until the expiration of the five years and its fair market value was includible in his income at that time. See, also, Charles F. Pearce, Jr., 6 B.T.A. 450; James R. Lister, 3 B.T.A. 475.

It seems clear that in exchange for his services for the next two years, the Company agreed to deliver to petitioner 25 shares of stock at the end of each year when the services had been performed. Performance of the services was a condition precedent to the delivery of the stock to petitioner. Petitioner argues that the signing of the contract to perform services in the future was sufficient consideration to make him the owner of the stock in 1942. But the Company was contracting for petitioner's services, not for his promise. The bare promise without the services had no value. The services called for by the contract were not performed until 1943 and 1944, in each of which years a certificate for 25 shares was delivered to petitioner for the services which he had rendered.

Moreover, a petitioner's contention that the mere signing of the contract was sufficient consideration for the transfer to him of ownership of the 50 shares is clearly contrary to the laws of the State of Ohio which were in effect at the time the parties entered into the contract. Section 8623-22, Page's Ohio Gen. Code Ann., in effect in 1943, reads as follows:

Payment for shares.—\* \* \* Shares shall be issued only for money, or for other property, real or personal, tangible or intangible, actually conveyed or transferred to the corporation for its use and lawful purposes, or in its possession as surplus, or for labor or services actually rendered to the corporation. [Emphasis added.]



\* \* \*

Every person who shall subscribe for shares without par value, or to whom such shares are to be issued, except as a share dividend, shall be obligated to pay the corporation therefor, in money or such other property or labor or services, such amount of consideration for each share as may have been determined as hereinbefore in this act provided.

Thus, under the laws of Ohio, petitioner could become the owner of the shares only upon the actual performance of the required services. See, also, Fletcher, *Cyclopedia of the Law of Private Corporations* (Perm. ed.), section 5187, pp. 424, et seq. And the laws in effect at the time shares of a corporation are issued become a part of the contract between the corporation and its shareholders and the parties to such agreement are presumed to know the extent of the authority granted the corporation by the applicable statutes then in effect. *Schaffner v. Standard Boiler & Plate Iron Co.*, 150 Ohio St. 454, 83 N.E. (2d) 192.

Petitioner places considerable reliance upon the case of *Schneider v. Duffy*, 43 Fed. (2d) 642. However, the facts in *Schneider v. Duffy* are distinguishable from the facts in this proceeding. In the *Schneider* case, the employment agreement provided that the corporation would assign "an equitable ownership" in 1,500 shares of stock to Schneider; that he was "entitled to receive and enjoy all of said 1,500 shares"; and that all dividends declared on the 1,500 shares would be transmitted immedi-

ately to Schneider. Schneider also had the right to vote all 1,500 shares. As a basis for its decision that the fair market value of all 1,500 shares was income in the year in which the contract was executed, the district court of New Jersey emphasized the fact that the stock agreement was not a contract for additional salary, but that it was an incentive given to Schneider, who had no ownership in the company, to remain with the business after he had expressed an intention to sever his connection therewith and organize a competitive company.

In this proceeding, however, petitioner needed no incentive in the form of stock to work for the Company. His former job as manager of the jig and fixture division of the American Coach and Body Company no longer existed upon the sale of that division outright to the Company. The Company did not agree to deliver a total of 50 shares of its stock to petitioner in order to persuade him to leave his employment with another corporation or to influence him to remain with the Company after he had expressed his intention to leave. Petitioner already had sufficient incentive as one of the organizers of the Company. In addition, under the employment contract, petitioner was entitled to 10 per cent of the profits earned each year by the Company above \$5,000.

The facts in this proceeding are more closely akin to those relied upon by the Board of Tax Appeals in *Anthony Schneider*, 3 B.T.A. 920, where it was held that income was taxable in the years subsequent to the issuance of stock, which considered



the same fact situation as that present in *Schneider v. Duffy*, *supra*, than they are to those relied upon by the court in the latter case. In the Board's view of the evidence, the agreement was entered into by the company in exchange for the services of Schneider and his agreement to remain with the company for the next five years. On these facts, the Board held that "performance of the agreements was the *quid pro quo* to the delivery of the absolute title to the stock," rather than the issuance of the stock, and that the fair market value of the stock was includible in Schneider's income in the years in which the certificates therefor were delivered to him without restriction. In subsequent cases, we have cited this decision of the Board with approval. *Charles F. Pearce*, *supra*; *K. E. Merren*, 18 B.T.A. 159; *Lyle H. Olson*, *supra*; *Albert R. Erskine*, 26 B.T.A. 155; *Charles Chaplin*, 46 B.T.A. 385; reversed on another issue, 136 Fed. (2d) 298.

Petitioner also relies upon *Chaplin v. Commissioner*, 136 Fed. (2d) 298; reversing in part 46 B.T.A. 385. We fail to see how that decision is authority for the contentions made by the petitioner. In the *Chaplin* case, the stock was issued in consideration of property in the form of photoplays to be delivered by Chaplin to the corporation, rather than for services to be rendered in the future. The stock was placed in escrow until such time as Chaplin delivered the photoplays. In reversing the decision of the Board of Tax Appeals that the fair market value of the stock was includible in Chaplin's income in the year in which he delivered the photoplays and the stock was re-

turned to him, the Court of Appeals relied upon the fact that the agreement specifically provided that Chaplin was the owner of the stock; that Chaplin had at all times the right to vote the stock, and that dividends on the stock were declared and paid to the escrow agent who held them for Chaplin's benefit. These facts are not present in the instant proceeding. Moreover, on the issue of whether the dividends which had been declared on the stock and paid to the escrow agent for Chaplin's benefit in prior years were includible in Chaplin's income in the year in which they were released to him upon delivery of the photoplays, the Court of Appeals held that the dividends were properly includible in Chaplin's income in the year of their release when they were unqualifiedly made subject to his demand, rather than in the years in which they were paid to the escrow agent. The decision on this issue supports the contention of respondent that the fair market value of the shares of stock was not includible in petitioner's income until the years 1943 and 1944, in each of which years 25 shares were delivered to petitioner without restriction.

It is held that the fair market value of the 25 shares delivered to petitioner in the year 1943 is includible in his gross income for that year, and the fair market value of the 25 shares delivered to petitioner in the year 1944 is includible in his gross income for that year.

Decision will be entered for the respondent.

Served August 31, 1950.

The Tax Court of the United States

Washington

Docket No. 21027

FRED C. HALL,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECISION

Pursuant to the determination of the Court in its Findings of Fact and Opinion promulgated on August 31, 1950, it is

Ordered and Decided: That there is a deficiency in income and victory tax for the year 1943 in the amount of \$614.96, and that there is a deficiency in income tax for the year 1944 in the amount of \$952.67.

[Seal]     /s/ MARION J. HARRON,  
Judge.

Entered Aug. 31, 1950.

Served Sept. 1, 1950.

In the United States Court of Appeals  
for the Ninth Circuit  
Tax Court Docket No. 21027

FRED C. HALL,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

PETITION FOR REVIEW

Taxpayer, petitioner in this cause, by Eli Freed, Emmett Gebauer, and Scott Fleming, counsel, hereby files his petition for a review by the United States Court of Appeals for the Ninth Circuit of the decision by the Tax Court of the United States promulgated August 31, 1950, 15 T.C. No. 30, determining deficiencies in petitioner's federal income and victory taxes for the calendar year 1943 in the amount of Six Hundred Fourteen and 96/100 Dollars (\$614.96), and in petitioner's federal income taxes for the calendar year 1944 in the amount of Nine Hundred Fifty-two and 67/100 Dollars (\$952.67), the decision determining said deficiencies having been rendered and entered August 31, 1950, after hearing by the Tax Court of the United States held in San Francisco, California; and petitioner respectfully shows:

I.

The petitioner, Fred C. Hall, is an individual residing in San Carlos, California; petitioner filed

the income tax returns involved with the Collector of Internal Revenue for the Eighteenth District of Ohio.

It has, however, been stipulated in writing between the petitioner and the Commissioner of Internal Revenue, respondent herein, pursuant to the provisions of Internal Revenue Code Sec. 1141 (b) (2), that the aforesaid decision of the Tax Court of the United States may be reviewed by the United States Court of Appeals for the Ninth Circuit. Said stipulation is attached hereto and marked "Exhibit A."

## II.

### Nature of the Controversy

The controversy involves the proper determination of petitioner's liability for federal income taxes and victory taxes for the calendar years 1942 and 1943, and income taxes for the calendar year 1944.

In 1942 the petitioner was employed in Cleveland, Ohio, by the American Coach and Body Company, an Ohio corporation, as manager of its Jig and Fixture Division. In November of 1942 the Ohio Aircraft Fixture Company, an Ohio corporation, acquired said Jig and Fixture Division, and proceeded to operate this division as a separate corporate business. On November 25, 1942, petitioner accepted employment with said Ohio Aircraft Fixture Company under a contract providing in substance as follows:

1. That petitioner would work for the Ohio Aircraft Fixture Company for two years.



2. That he would be paid a stipulated, reasonable, fixed salary.

3. That he would receive a bonus of ten per cent (10%) of the profits over Five Thousand Dollars (\$5,000.00) per year.

4. That part of said salary and all of said bonus might be paid in stock of the corporation.

5. That the corporation would issue fifty (50) shares of its stock to petitioner in the form of two twenty-five share certificates; that petitioner was to endorse said certificates in blank and deposit them with the treasurer of the company to secure the faithful performance of the contract; said certificates were to be redelivered to petitioner, one in 1943 and the other in 1944.

In accordance with this contract fifty shares of stock were issued to petitioner in 1942, endorsed and deposited by him, and returned to him, twenty-five shares in 1943 and twenty-five shares in 1944.

Petitioner reported the fair market value of these shares of One Hundred Dollars (\$100.00) per share, or Five Thousand Dollars (\$5,000.00), as ordinary income on his return for the calendar year 1942.

The Commissioner of Internal Revenue asserted tax deficiencies for the calendar years 1943 and 1944 on the ground that the income represented by said shares of stock was not realized by petitioner in 1942 but was instead realized one-half in 1943 and the other half in 1944.

## III.

The aforesaid assertion of tax deficiencies was sustained by the Tax Court of the United States, and petitioner, being aggrieved by the findings of fact and opinion of said Court and by its decision entered pursuant thereto, desires to obtain a review thereof by the United States Court of Appeals for the Ninth Circuit.

## IV.

## Points on Which Petitioner Relies

The petitioner relies upon the following points:

1. The contract and the testimony require the conclusion that petitioner became the beneficial, equitable, and substantial owner of the shares of stock in question in 1942, and that the value thereof constituted taxable income to the petitioner in 1942.

2. The contract under which the shares were issued to petitioner and deposited by him with the company requires the conclusion that both parties to said contract intended that petitioner became a shareholder in 1942, when the fifty shares in dispute were originally issued to him, and that the deposit of said shares with the corporation was merely a pledge or security device which did not prevent realization of income in 1942.

3. Creditable, uncontradicted, and unimpeached testimony of the petitioner, the only witness at the hearing, requires the conclusion that petitioner became a shareholder in 1942, and that the deposit of his shares with the company was merely a pledge



or security device which did not prevent realization of income in 1942.

4. A taxpayer on the cash receipts basis is required to include income in his return for the taxable year during which the income is received. Income in the form of property, including shares of corporate stock, is received or realized in the year in which the taxpayer becomes the beneficial, equitable, or substantial owner of such property or shares.

5. Even though tangible share certificates are not then actually issued, income arising by virtue of the creation of the legal relationship of shareholder in a corporation is realized in the year such relationship is created.

6. The fact that a taxpayer receives the beneficial, equitable, or substantial ownership of corporate shares or other property constituting income to him, subject to restrictions in that such corporate shares or property must be pledged or deposited as security or that the taxpayer's use thereof is otherwise restricted, does not prevent or postpone realization of the income represented thereby.

7. A cash basis taxpayer is required to include an item in gross income for the year in which it is received, even though the services for which it constitutes compensation are not to be rendered until a subsequent year.

8. The Tax Court erred in relying as a partial

or supporting reason for sustaining the Commissioner's contentions on the ground that under Ohio law the shares could not have been issued to petitioner in 1942, which issue or contention had not been raised by respondent's answer to the petition nor referred to in any way in the trial or argument of the case or the briefs submitted therein, and regarding which issue petitioner had no reason to expect that he should put in any evidence and no opportunity to present evidence, and which is contrary to the Commissioner's stipulation in open court that the shares in question were issued in 1942, and contrary to the undisputed fact that the shares in question had, in 1942, a fair market value of One Hundred Dollars (\$100.00) per share, or Five Thousand Dollars (\$5,000.00).

9. The Tax Court erred in concluding that under the facts and circumstances of this case the Ohio law operated to prevent petitioner from having the status of a shareholder in 1942 in accordance with the contract and intention of the parties.

10. The Tax Court erred in relying on facts and assumptions not in evidence and not supported by the evidence.

11. The Tax Court erred in making the following findings of fact:

“Petitioner became the unrestricted owner of 25 shares of stock in the Company in 1943 in exchange for services which he rendered to the Company in that year.

“Petitioner became the unrestricted owner of 25 shares of stock in the Company in 1944 in exchange for services which he rendered to the Company in that year.”

12. The decision of the Tax Court is not supported by the evidence and is contrary to the evidence.

13. The decision of the Tax Court rests on errors of law and is contrary to law.

14. The Tax Court erred in determining the deficiencies for the years 1943 and 1944 and that the income in question was not properly reported and the tax paid thereon for the year 1942.

/s/ ELI FREED,

/s/ EMMETT GEBAUER,

/s/ SCOTT FLEMING,

Counsel for Petitioner.

Received and filed T.C.U.S. November 24, 1950.

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[Title of Court of Appeals and Cause.]

NOTICE OF FILING PETITION FOR  
REVIEW

To the Commissioner of Internal Revenue, respondent herein, and to Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, Washington, D. C., his attorney:

You are hereby notified that the petitioner has filed on or about November 24, 1950, with the Clerk

of the Tax Court of the United States at Washington, D. C., a petition for review by the United States Court of Appeals for the Ninth Circuit of the decision of the Tax Court of the United States heretofore rendered in the above-entitled matter. A copy of the petition for review and the designation of contents of record on review, as filed herein, are attached to this notice and served herewith.

Dated: November 22, 1950.

/s/ ELI FREED,

/s/ EMMETT GEBAUER,

/s/ SCOTT FLEMING,

Counsel for Petitioner.

Acknowledgment of Service attached.

Received T.C.U.S. November 24, 1950.

Filed T.C.U.S. November 27, 1950.

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[Title of Tax Court and Cause.]

### CERTIFICATE

I, Victor S. Mersch, Clerk of The Tax Court of the United States hereby certify that the foregoing documents, 1 to 12, inclusive, constitute and are all of the original papers and proceedings on file in my office as called for by the Designation as to Contents of Record on Review in the proceeding before The Tax Court of the United States entitled, "Fred C. Hall, Petitioner, v. Commissioner of Internal Reve-

nue, Respondent," Docket No. 21027 and in which the petitioner in The Tax Court proceeding has initiated an appeal as above numbered and entitled, together with a true copy of the docket entries in said Tax Court proceeding, as the same appear in the official docket book in my office.

In testimony whereof, I hereunto set my hand and affix the seal of The Tax Court of the United States, at Washington, in the District of Columbia, this 13th day of December, 1950.

[Seal]      /s/ VICTOR S. MERSCH,  
Clerk.

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[Endorsed]: No. 12803. United States Court of Appeals for the Ninth Circuit. Fred C. Hall, Petitioner, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Petition to Review a Decision of The Tax Court of the United States.

Filed December 30, 1950.

/s/ PAUL P. O'BRIEN,  
Clerk of the United States Court of Appeals for the  
Ninth Circuit.

[Title of Court of Appeals and Cause.]

POINTS ON WHICH PETITIONER  
INTENDS TO RELY

As and for the points on which petitioner intends to rely, petitioner hereby refers to and incorporates herein, as though fully set forth, the points on which petitioner relies constituting paragraph IV, subparagraphs 1 through 14, inclusive, commencing on page 4 and ending on page 7 of petitioner's Petition for Review heretofore filed herein and constituting Document No. 5 in the attached Designation of Printed Record for Review of Tax Court Decision.

Dated: January 15, 1951.

/s/ ELI FREED,

/s/ EMMETT GEBAUER,

/s/ SCOTT FLEMING,

Counsel for Petitioner.

Affidavit of Service by Mail attached.

[Endorsed]: Filed U.S.C.A. January 23, 1951.

